March 21, 2013

Representatives,

As a volunteer certified tax preparer (under the IRS VITA program) and a holder of an economics degree, I am a bit of a “tax nerd”. As such, I have given much consideration to the problems that lie is the current tax code. The sheer number of people who do not feel comfortable filing their own tax returns is proof of how complicated the system is. I routinely see clients who have no idea how the whole thing works, or worse, have made some detrimental financial decision based on misunderstanding of the tax code.

The area of most confusion for individual filers is often credits and deductions. Economically speaking, credits and deductions reduce cost, and should have the effect of encouraging certain behaviours, such as pursuing college education, owning a home, and having children. However, because the credits and deduction are so numerous, and because each one individually has its own amounts and restrictions, I argue that the effect of behaviour modification in the general population is largely nullified. The number of people who are advantaged by a credit or deduction are outweighed by those who are harmed by it either through misunderstanding or it or ignorance of its existence.

For the minority who take time to understand the implications of credits and deductions, there is concern that the tax code is encouraging behaviours that should *not* be encouraged. I will describe three:

1) **PMI deduction**. Making home purchases with reasonable down payments should be encouraged; giving a deduction to buyers who do not is counter-intuitive.
2) **Mortgage interest deduction**. This deduction effectively makes paying interest cheaper, and therefore larger mortgages become more affordable. Purchasers who buy as much house as they can afford benefit over sensible purchasers of more modest homes.
3) **Property tax, state income tax and state sales tax deductions**. These deductions effectively serve as a subsidy for residents of high-tax states. Taxpayers of Rhode Island get a special deduction, while those in New Hampshire do not. The federal tax system should not be picking favorites among the states. These deductions amount to preferential treatment to poor budgeting practices.

To address the concerns that eliminating real estate deductions will be harmful to either the housing market or the middle class, consider:

1) Most filers take the standard deduction, so removing some itemized deductions will not impact the most filers.
2) Larger mortgages and mortgages with low down payments are riskier. I contend that risky mortgages propping up housing prices is less desirable than a stable housing market at a slightly lower price level.
3) Canada does not have a mortgage interest tax deduction, yet this has not impacted the homeownership rate. The Canadian housing market has also been less volatile.

I hope you will consider these proposals as a small part of a major overhaul of the tax code.

Chris Buccella